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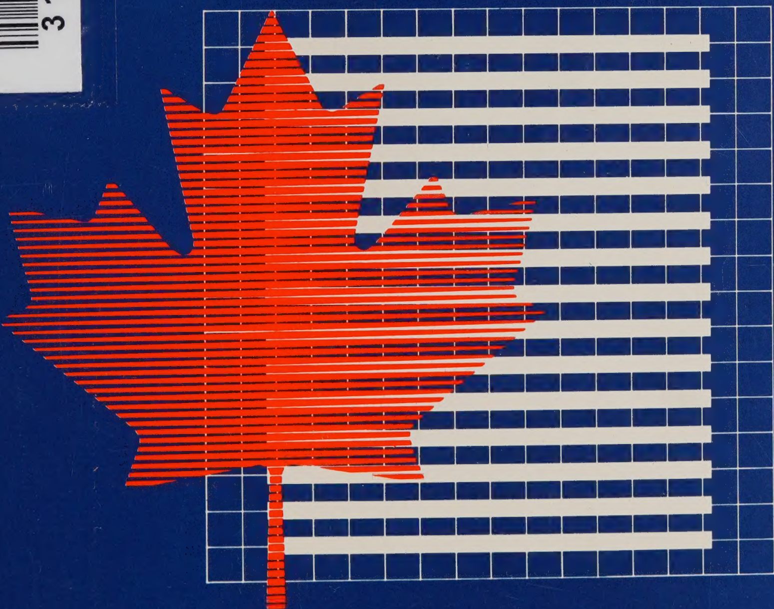
Systems of government, economic associations. . . and how they work



Canada

REFERENCE TEXTS

Systems of government, economic associations. . . and how they work

Note: This publication is also available in French

Note: Cette brochure est également disponible en français

Cat. No. CP 46-4/1984E

ISBN 0-662-13619-5

Table of contents

Introduction

fed-er-a-tion (fed/e ra/shen), *n.* the formation of a political unity with a central government, by a number of states, which become members while retaining control of their own internal affairs.

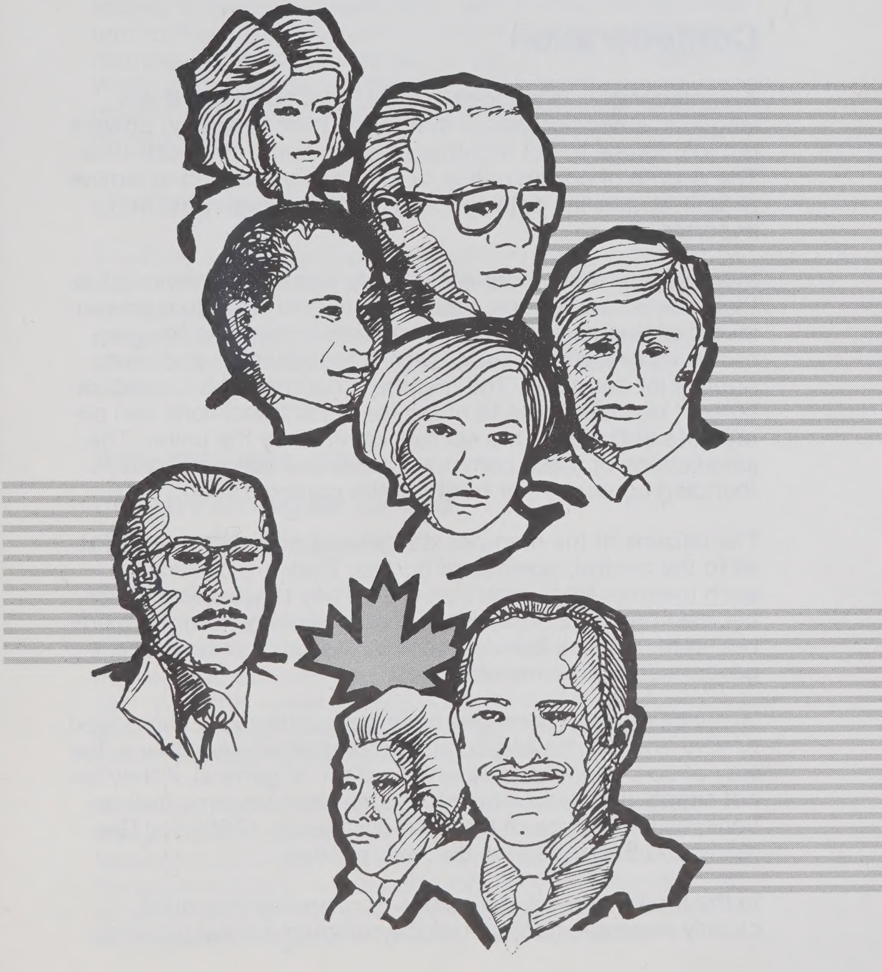
In 1867, the Fathers of Confederation chose to make Canada a federation. They saw this type of association as the best for Canadians. Through it, their needs could be met and their aspirations realized.

The Fathers were right. The system worked then and it is working now.

This booklet combines under a single cover four texts that were written and produced originally as separate publications. They have since been revised and updated. Their purpose, though, remains the same: to promote a greater understanding of the federal system of government — ours in particular — and to compare it with other arrangements. The first chapter compares federations with *confederations* and *unitary* systems, both of which were rejected by the Fathers of Confederation. The next chapter looks at the development of federalism throughout the world. And then there is a text comparing an economic-political union (Canada) to an exclusively economic union (the European Common Market) to demonstrate the differences between these two types of association. The final text looks at the flexibility of Canadian federalism in the context of constitutional arrangements (how power is shared in the federation between the national government and the provincial governments), and financial arrangements (how economic policies work to equalize benefits and burdens for citizens of the federation) with emphasis on the latter.

If you would like additional copies of this or other material on federalism, please fill in and mail the coupon at the back of the booklet.

1. Confederation, federation, unitary system



Confederation, federation, unitary system

Canadians refer to what happened in 1867 as Confederation. But in that year when Canada was born as a country, it was not as a confederation at all, but as a *federation*. The two terms caused some confusion then, and they still do. This chapter explains the difference and also describes a third kind of government, the unitary system.

Confederation

A confederation is a society made up of societies. It is a league of sovereign states that retain their sovereign powers but join forces to act together or co-ordinate their activities. The degree of co-ordination or joint action may be extensive or limited, and the activities may vary in number and in importance.

In a confederation there are not two levels of government as there are in federations: there are only the individual governments of the participating member countries. It is the governments of the member countries that develop and then apply joint decisions. The member countries of a confederation set up institutions to make these joint decisions and co-ordinate activities in the sectors covered by the union. The jurisdictions of these common bodies are defined in the founding agreement or treaty of the confederation.

The citizens of the member states have no direct relation at all to the central, confederal bodies. They are citizens of each member state, and that is all. They pay taxes only to the member state. They receive services only from the member state. And if it is a democracy, they vote only for the government of the member state.

Historically, confederations have been either very short-lived or very artificial, having in fact accomplished very little in the way of co-ordinated, concerted action. In general, if they are not simply dissolved, confederations soon become federations, as in the case of the United States in 1789, and Germany and Switzerland in the 19th century.

In the modern world, the unions of countries that most closely resemble confederations are international organiza-

tions, such as the North Atlantic Treaty Organization or the European Economic Community. There are no true confederations in the world.

Federation

In a federation, there are two orders of government, each enjoying sovereignty within the limits of its constitutional jurisdiction. Citizens of a federation deal with both orders of government: in the case of some issues, they deal with the federal or national government, and in other matters they turn to the regional or provincial government (that of the member state, called a state, province, canton, region, etc.). What characterizes a federation, then, is that two sovereign governments with complementary jurisdictions co-exist in a given area.

Unitary system

A unitary system is one that has only one government. A country that adopts a unitary system may nevertheless set up decentralized bodies with limited powers, such as municipal administrations. France, Italy and the United Kingdom are examples of countries with unitary systems of government.

Advantages and disadvantages of the different systems

Unitary system

The simplicity of a unitary system is one of its advantages: there is only one government or authority responsible for making and adopting policies in the interest of the population. With this system, there is no confusion as to which government collects taxes and develops and administers programs to respond to citizens' needs.

However, the unitary system generally is not the best equipped to respond to the needs of a population distributed over a large territory, as the people tend to feel that the government is remote and inflexible. Furthermore, for a large territory a unitary regime scarcely allows for the full expression of regional and ethnic characteristics.

Confederation

The main drawback of confederations is their inability to reconcile the different interests of the various member countries. Joint action is taken only when there is unanimous agreement among the member countries. Therefore, it is unlikely that a confederation would ever adopt a policy for equalizing revenues through either transfer payments among governments or allowances to individuals. Such an equalization policy, although it brings considerable benefits to all in the long term, would certainly be rejected by the richest countries of the confederation. The institutions of the confederation, lacking the necessary power or authority, could not force a compromise on the parties.

Furthermore, since a confederation's institutions have little power or authority, they do not create a feeling of solidarity among citizens of member countries. The people of each member country give allegiance to their government alone and lose sight of the interests that they may have in common with the populations of the other countries. Consequently, priority is given to regional interests and policies producing immediate results, rather than to more universal values and long-term results.

In a confederation, common options are not given the same weight as special interests. In the end, rivalries, jealousies, disagreements and insoluble disputes render the confederation powerless. It no longer serves the purposes of the association, and is either dissolved or transformed.

The most notable confederations, those of the United States (1781-1788), Germany (1815-1866), and Switzerland (1815-1874), were reorganized as federations when their members realized that a federal structure would further the common objectives that could not be attained through a confederation.

Those countries did not choose unitary systems, because such systems make it difficult to respond adequately to the special needs of very diverse regions or of communities with distinct languages, religions or cultures.

In the case of the United States, Switzerland, Germany and many other countries containing very different regions or distinct communities or societies, a federation was the political organization considered best suited to the objectives of

common action in certain fields and respect for the diversity of interests in others.

Federation

For groups of people all over the world, a federal form of government has been shown to have many advantages over both the confederate and unitary systems.

In a federation it is possible to achieve compromises with respect to common objectives despite the special interest of certain groups, which must then be compensated, and, at the same time, to realize the particular objectives of the regions. The structure ensures both the preservation of regional identities and community loyalties and the development of solidarities that go beyond regional boundaries and cultural differences.

One of the advantages of a federal system for each member state or province is that the national government can mobilize the collective resources of the whole nation to undertake big projects and implement needed policies.

Canada is an excellent case in point. Working together, the governments of the Canadian federation have succeeded in developing the second largest country in the world. In the 19th century, while the Government of Canada was extending the railway network and implementing the commercial policies needed for development, the governments of the provinces were establishing their programs and services and organizing their municipalities. Later on, in the first half of the 20th century, the provincial governments were busy expanding highway and electrical energy distribution networks and pursuing economic, social and cultural programs adapted to their populations' needs.

Meanwhile, the Government of Canada began establishing telecommunications and air transport networks for the whole country, consolidating the achievements of earlier development and setting up the first programs of transfer payments to provinces and to individuals, thus laying the foundations of an "equalization" policy that was to produce positive results and become the envy of many nations.

Would this have been done if Canada had adopted a unitary system with only one government?

Could this have been done if Canada had been a confederation of separate countries, with no central government?

To both questions, the answer is "no." And most Canadians, in all regions, would unquestionably be less well-off today, economically, socially and culturally.

A unitary system simply could not cope with the realities of Canada—its geography; the dependence of the economy on the land's natural resources and on international markets; the cultural and linguistic differences of its regions and provinces.

And a confederation with no central government could never come to grips with the need to strive for economic development and equalization of standards of living from one end of the country to the other.

Canadians in all provinces gain when Canada speaks to the world with a single voice to negotiate trade agreements with foreign countries. International defence treaties enhance the security of Canadians wherever they live. And the strength of one government representing all Canadians establishes and secures our sovereignty, which is especially important in the Far North and offshore, where rich resources are waiting to be developed.

Conclusion

A confederation sacrifices the interests of the whole to those of the member countries. A unitary system sacrifices the special interests of its regions to the interests of the whole. The federation is the political system that enables its citizens to participate to the greatest extent in the administration of public affairs. It is the happy medium between the extremes of centralization (unitary system) and decentralization (confederation).

Thanks to countless arrangements, compromises and exchanges of opinion among governments, Canadian federalism has given the residents of all provinces high-quality government services. It has helped reduce disparities among provinces, regions and citizens. Regardless of what its detractors may say, the federal form of government is the only one that can guarantee Canadians the advantages of belonging to a large country and at the same time promote the attainment of their provincial and regional aspirations.

2. Federalism throughout the world

Federalism throughout the world

Creating a country from a scattered collection of small colonies was one thing. Finding a workable system of government was another. The Canadian Fathers of Confederation had only to look south of the border for two examples—one of failure, the other of remarkable success. This chapter examines federalism and its workings. How does it operate? What is its origin? What countries have adopted it?

A brief look at history

From 1781 to 1788, the United States of America was a confederation. It broke down completely. The confederal authority could get neither action nor money from the sovereign states to carry out its decisions. So the confederation was scrapped in 1789 and replaced by a federation.

The rest, of course, is history. And the American model was to be an important influence on most of the federal systems that came later. The U.S. demonstrated how sharing resources can spur the rapid progress of an entire country.

For many years Switzerland tried to make a confederation work. But in the mid-19th century it too switched to a federal form of government.

For the pragmatic Swiss, the problem was not one of welding together diverse communities scattered over vast distances. But in their small land all of the other factors were present to make federalism the answer they sought. The Swiss cantons united in a federation to build their economic strength and military security, while at the same time preserving the distinct languages and cultures of the people.

Federalism was born in part out of economic necessity. The Industrial Revolution transformed the means of production, trade and economic relations among countries.

With steam engines and other new technology, factories and industrial areas replaced small workshops where goods were made by hand. Better transport made it possible for merchants to sell more of their products farther abroad.

This new economic situation created a new interdependence among regions and nations. It also prompted leaders of the new industrial powers to think about reorganizing their political arrangements.

What emerged was an understanding of what today may seem both simple and obvious: when you create a larger political unit, you also create a larger economic unit. Your domestic market is bigger. So is your capacity to produce goods for export. And everyone benefits from the pooling of talents, energies and resources.

For economic and other important reasons, the 19th century saw the adoption of federalism in Canada, Switzerland, Australia and Brazil.

Events of the 20th century, including two world wars, prompted a number of countries to choose the federal system as the means of achieving greater stability.

Mexico became a federation in 1917. Venezuela and Argentina joined the club after World War II. In 1949 West Germany elected its first federal parliament. India gained independence from Great Britain in 1947 and set up a federal system three years later. Yugoslavia adopted federalism in 1947 and Czechoslovakia in 1970.

In Africa, the end of the colonial era encouraged the growth of federalism, since the system allows different ethnic groups to join while retaining their special characteristics. Nigeria, which has a population of more than 60 million, and Cameroon, with a population of only six million, both decided as newly-independent countries to establish federal systems.

How does it work?

The federal system can take a number of different forms, although in general it gives the national government economic and political strength while at the same time respecting the special character of the regions. Let's look at three examples.

Switzerland chose the federal system because it best suited the needs of that country's three major language groups—

German, French, and Italian. The Swiss constitution recognizes three official languages and guarantees each citizen the right to communicate with the central government and to stand trial in any one of those languages.

In the United States, the federal system is presidential, not parliamentary as in Canada. The U.S. constitution protects regional interests by having each state elect two members to the Senate, whatever the state's population. At the same time, the American population as a whole elects the president whose responsibility it is to promote the national interest.

The Federal Republic of Germany has also adapted the system to meet its own special needs. The West German constitution, which is recent and modern, is extremely flexible. Rather than establish clear divisions between the jurisdiction of the central parliament and the Länder (which are the equivalent of provinces), the Germans allowed for a broad field of concurrent legislation, but with the federal law taking precedence over that of the Länder. In practice the Länder confine themselves, as a rule, to administering federal legislation. The Federal Republic of Germany is relatively homogeneous culturally, but cultural matters are the responsibility of the Länder. They in turn have preferred to develop cultural policy on a national rather than a regional basis. This is another example of federalism adapting to the desires of the citizenry as a whole.

More than half of the world's population is now living under a federal system if you include the Soviet Union. This kind of system has been established on every continent. In some cases, it is adopted as a means of uniting different language or ethnic groups, while in others it is made necessary and desirable by the vast expanse of territory to be governed. In every case, however, the national government and the member states co-operate to create better services for the country's population. Whether they be Canadian provinces, Swiss cantons or American states, each member unit safeguards the particular regional character, while the Canadian Parliament, the German presidency and federal parliament, and the American presidency and federal Congress preserve the solidarity and interdependence that promise progress for the whole country.

3. The Common Market and the Canadian experience

The Common Market and the Canadian experience

The European Economic Community (Common Market) is one form of economic association. So is the Canadian federation, among many other things. As a working political and economic partnership, Canada has been in business a lot longer than the EEC. But the EEC is a vastly larger unit, with a population of around 270 million. The Common Market is probably as close as one can come to a modern-day example of a confederation at work. Some have called it an "embryo federation." This chapter takes a brief look at the EEC, its origins and evolution, and compares it with the Canadian experience.

The search for stability

The idea of European unity was not a new one. Napoleon III of France saw the need for it in the 19th century, and advocated the creation of a European confederation.

But it took the devastation of two World Wars to jolt the continent's leaders into doing something about it. Clearly, the disasters that marked the first four decades of the 20th century must not be repeated. The need for stability was all too obvious, and the way to achieve it was through political and economic integration.

World War II had left Europe divided. The nations of Western Europe found themselves caught between two superpowers—the United States and the Soviet Union. The Soviet sphere of influence covered all of Eastern Europe. The military threat posed by the powerful Eastern bloc led to the creation in 1949 of the North Atlantic Treaty Organization (NATO), a defence alliance embracing 10 European nations plus Canada and the United States.

On the economic front, Western European nations saw the need to ensure their prosperity and to be able to compete in world markets with the great commercial powers. The first step was creation of the Organization for European Economic Co-operation (OEEC), a union of 16 countries whose main purpose was to co-ordinate the distribution of postwar reconstruction assistance provided by the U.S.

Then came three different attempts to unify groups of European countries: the Scandinavian unification project, never brought to fruition; the France-Italy union, which did not progress beyond the negotiation stage, and the successful creation of Benelux, an association grouping Belgium, the Netherlands and Luxembourg.

In 1951, the European Coal and Steel Community (ECSC) was created by the Treaty of Paris. But the Europeans soon discovered it was unrealistic and not very efficient to seek association in only a small number of economic sectors. They also discovered that economic activities are strongly influenced by political activities.

In 1957, the Treaty of Rome extended economic integration through the establishment of the European Common Market. The new association included the Federal Republic of Germany, France, Italy, the Netherlands, Belgium and Luxembourg. Four institutions—the Council of Ministers, the Commission, the Court of Justice and the European Parliament—were established to administer this economic association, from headquarters in Brussels. In 1984 there were 10 EEC member countries, with Great Britain, Ireland and Denmark having joined in 1973, and Greece in 1981.

Common Market institutions

The Council of Ministers

The Council of Ministers is the principal decision-making body. The government of each nation in the community has a seat on the council. The foreign minister is usually a country's main representative, but a government is free to send any of its ministers to council meetings.

For some particularly important decisions by the council, unanimous agreement is necessary, but in principle most decisions can be taken by a qualified majority. For this, the votes of members are weighted according to population. However, the council never imposes a decision on a member in a matter that the member considers to be of vital national interest. In most decisions of the council, unanimity is aimed at and generally achieved.

The Commission

The Commission is the most important administrative body of the Common Market. It has certain powers to implement

the various treaties uniting the member countries. All of these countries do not, however, wield the same power of influence within the Commission. The four most important ones, Germany, France, Italy and Great Britain, each have two representatives on the Commission while the others have only one. Thus, all the countries involved in the European economic association are not necessarily on an equal footing. The influence each country has is roughly equivalent to the size of its population and the importance of its economy.

The Court of Justice
The Court of Justice is composed of nine judges appointed by agreement among the governments of the member countries. The court ensures that the law is respected in the interpretation and application of the Common Market treaty. The court may oblige member countries to meet any unfulfilled obligations under the treaty. It may also impose sanctions on member countries.

The European Parliament
The European Parliament is directly elected by voters in the member nations. The number of delegates for each country is proportional to the size of its population. The Parliament has very limited powers. It gives its opinion on any draft decisions prepared by the Commission for the Council of Ministers. It also adopts, amends or rejects the European Community's budget.

The Court of Auditors
Established in 1977, the Court of Auditors keeps a check on Community budget spending. It has nine members who are appointed by agreement among the governments.

Development of the Common Market

The Treaty of Rome made it possible for workers, capital and companies to move freely among member countries, which adopted a common trade policy with respect to non-member countries and gave up their right to conclude separate trade agreements. Thus, in joining forces on the economic level, the members of the Common Market had to surrender some of their sovereignty.

But the loss of a degree of independence was offset by the very positive results of the creation of a single commercial

market: trading among member countries, industrial production and the standard of living all rose dramatically.

In achieving its position as an economic power, the EEC has taken on some of the aspects of a federal system. These include the provisions for free movement, notably of goods and people, and the attempt to harmonize economic policies through the European Monetary System and in other ways.

But in other important respects the Common Market is a long way from becoming a federation. Among the elements lacking are a common foreign policy and common defence forces. There is no directly-elected Community government. Nor have there been efforts to harmonize national social security systems and benefits. The EEC budget remains relatively small, and so does spending on redistribution of income.

But of course federal systems also encounter problems, and Canada's has shown some weaknesses in recent years. For example, in some respects the EEC treaty and rules on free movement of goods, services, people and capital are stronger than those in Canada. The EEC experience is clearly relevant in any examination of the Canadian system.

The Canadian situation

By choosing a federal system of government in 1867, Canada effected the political and economic union of citizens from different regions and ethnic groups. Thus, for more than a century, Canadians have profited from the advantages of the political and economic integration that many Europeans are now pursuing.

Like the European Community, we created an enlarged domestic market in which goods can move freely across provincial boundaries, without tariffs being imposed.

But in Canada we have many things the EEC does not have. We have a national government with a mandate conferred directly by the Canadian population. By contrast, member governments of the EEC can stall negotiations and prevent decisions being made.

Canada has a common foreign policy, common defence policy, a national trade policy and one system of currency.

Our federal system creates a framework in which Canadians can co-ordinate economic and social activities. We have a long-established policy of sharing our national wealth that has helped to reduce regional disparities.

Today the Atlantic provinces, Quebec and Manitoba receive large annual payments through Canada's federal equalization program. Manitoba is the only Western province that qualifies for these payments. But it wasn't always that way. In past years substantial payments were made to other Western provinces, when the region was less prosperous than it is now.

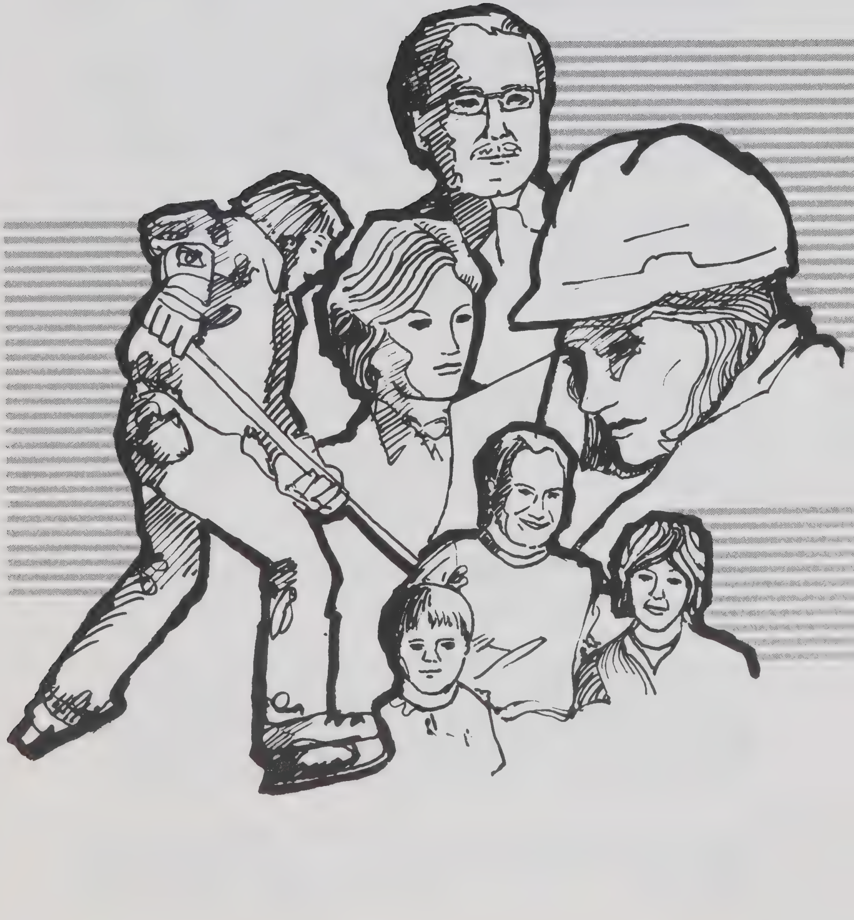
In a federal system, the poorer members are not at the mercy of the wealthier ones. But a federation is more than just a financial arrangement. It is a country in the true sense of the word, and as such establishes ties of solidarity among the people of its member units. That is not to say tensions and frictions never develop in a federation. They do, and Canada has its share of them, for example over questions of jurisdiction between the two levels of government.

But our system, with its built-in flexibility, is obviously the one best suited for reconciling regional differences while striving to attain national objectives—better by far than a simple association or confederation, where every decision requires unanimous consent.

In times of crisis or national emergency, or when circumstances require massive projects for the collective good of the nation, there are obvious advantages in a federal system that permits 25 million Canadians to work together.

The European experience demonstrates the need of members of an economic association to seek political integration. Canadian federalism, on the other hand, is an established political and economic association whose advantages far outweigh the limited benefits of a simple economic union.

4. The flexibility of Canadian federalism



The flexibility of Canadian federalism

Introduction

Language, culture, geography, economics and security are among the factors that usually motivate people to create federal political unions.

The big appeal of the whole concept of federalism is the flexibility with which it can respond to particular situations, to pursue common goals while protecting the interests of its member communities.

In Canada, it began in 1867 as the union of four provinces. The union has been expanding, evolving and adapting to changing circumstances ever since. If the Fathers of Confederation came back to Canada of the 1980s, would they recognize the country they created?

There may be a common concept underlying federalism as a system, but because of its very nature there is no common world-wide model. Because it is flexible and adaptable, the federal system works in different ways to meet different kinds of special needs.

This chapter will examine the flexibility of the system as it has evolved in Canada, with emphasis on financial arrangements to give some indication of the shifting balance between economic centralization and decentralization over the years.

Centralization and decentralization—historical overview

Centralization and decentralization within the context of Canadian federalism remain at the heart of political debate in Canada. History shows that regardless of the merits of arguments on either side of the case, the Canadian experience has been one of adapting to meet changing needs.

For example, during two World Wars the pendulum of power swung to the federal government, as it did in most Western federations.

During the Great Depression in the 1930s, the Canadian public insisted that the federal government assume national leadership to alleviate the effects of economic instability and to affirm the right of all Canadians to enjoy a certain standard of living. These demands called for a degree of centralization. The Government of Canada broadened its economic activities and implemented social programs such as Unemployment Insurance. Provincial governments in 1940 agreed unanimously that this program to aid workers should be in the hands of the national government.

After World War II, the demands on provincial governments increased dramatically. To serve growing populations, they had to spend heavily on hospitals, schools and social assistance. They invested enormous sums to develop hydro, steam and nuclear electrical generating capacity. New highways have been built and old ones modernized. And the provinces are involved in a host of other activities, from promoting industrial growth to protecting the environment.

In the process of adapting over the years to meet the changing needs of Canadians, Canada has thus seen periods of both federal and provincial domination of public affairs, and periods of centralization have alternated with periods of decentralization.

The late Senator Maurice Lamontagne, once a professor of economics at Laval University, commented on the evolution of Canadian federalism as follows:

> In the Canadian perspective, the status quo that is so much discussed these days corresponds much more to a myth than to reality. In fact, our federalism has always been one of the most flexible in the world. Since 1867, we have known four different regimes, within a Constitution that has remained largely the same. First, we had a very centralized system within which the federal government exercised all the major responsibilities of the state, the provinces being relegated to the role of large municipalities. After the First World War, the provinces assumed a dominant role within Confederation. The federal hegemony reappeared with the Second World War, but the provinces, especially since 1957, when the formula of equalization payments was applied, again began to play a central role within Canadian federalism.[1]

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[1]Senator Maurice Lamontagne, *Federalism or an Association of Independent States,* University of Montreal, April 6, 1977, p. 19.

The shifting of activity or influence between the national government and the provinces is illustrated by the distribution of direct expenditures on goods and services among the various governments over the years.

Table 1

Percentage distribution of direct expenditures on goods and services and gross capital formation*

	Federal government %	Provincial and local governments %
1926	26	74
1930	25	75
1940	60	40
1950	41	59
1960	39	61
1970	29	71
1980	27	73
1983	26	74

SOURCE: Statistics Canada, *National Income and Expenditure Accounts*.

* Current expenditures on goods and services and capital formation only. These figures do not include, for example, transfer payments to individuals or, in the case of the federal government, transfers to other levels of government. Excludes hospitals and the Canada and Quebec Pension Plans.

Since World War II, all governments in Canada, and in the Western world in general, have seen their activities and expenditures grow rapidly. In Canada, the provincial and municipal governments have recorded by far the highest rate of growth. From 1960 to 1979, the total expenditures of the national government grew by a multiple of about seven while those of the provincial and municipal governments increased by more than 11 times. This assumes federal transfer payments viewed as expenditures at the provincial-municipal level.

This increase in government activity in Canada meant that the two orders of government began to work together and co-operate more closely.

And as a result federal-provincial consultation has become one of the most important features of our federal system.

The political processes and mechanisms of Canadian federalism have never been static. Negotiations and accommodations go on continuously. They reflect the internal play and balance of forces between the desire to promote diversity, so that our provincial governments can grow and pursue their own interests, and the desire to ensure widespread shared prosperity and stability, so that the Canadian government can effect common purposes and deal with common problems.

The shifting emphasis between centralization and decentralization can be seen in the following tabulation of federal and provincial shares of total government expenditures and total government revenues over the past half-century.

Table 2

Percentage distribution of total government expenditures*

	Federal government %	Provincial and local governments %
1926	38	62
1930	33	67
1940	56	44
1950	52	48
1960	51	49
1970	38	62
1980	40	60
1983	43	57

SOURCE: Statistics Canada, *National Income and Expenditure Accounts.*

* Federal transfers to provincial and local governments are treated as expenditures by the recipient levels of government. Excludes hospitals and the Canada and Quebec Pension Plans.

Table 3

Percentage distribution of total government revenues*

	Federal government %	Provincial and local governments %
1926	43	57
1930	28	72
1940	51	49
1950	60	40
1960	49	51
1970	40	60
1980	35	65
1983	34	66

SOURCE: Statistics Canada, *National Income and Expenditure Accounts*

* Federal transfers to provincial and local governments are treated as revenues of the recipient levels of government and are deducted from federal revenues. Excludes hospitals and the Canada and Quebec Pension Plans.

What these tables show is that there has always been a good deal of financial or fiscal flexibility in the functioning of the Canadian federation. This flexibility has been considerably enhanced over the post-war years by what are known as federal-provincial fiscal arrangements. These arrangements consist of three closely integrated features: tax harmonization, fiscal and economic co-ordination, and intergovernmental transfers.

First, tax harmonization. The major feature of tax harmonization allows the federal government and the provinces to exercise their respective powers of income taxation in a manner that helps to foster tax harmony and to decrease the complexity of the income tax system. It also reduces significantly the cost of tax collections and simplifies procedures for taxpayers. This is achieved mainly through tax collection agreements under which the federal government collects the personal income taxes levied by all provinces except Quebec, and the corporate income taxes of seven provinces.

The second feature of fiscal arrangements involves fiscal and economic co-ordination. The mechanisms to achieve this co-ordination are not formalized and have no legislative

basis, but they play an important role in the joint management and periodic review of the other two facets. Central to this co-ordination process are the meetings that federal and provincial ministers of finance hold at least once a year to review the economic outlook and consider what would be the most appropriate budget response by each order of government. A continuing committee of officials deals with technical issues and prepares a common basis of economic information and analysis for ministerial meetings.

The third and best known feature of fiscal arrangements is intergovernmental transfers. The federal government makes unconditional or conditional cash and tax transfers to provincial governments for a wide variety of purposes. In fiscal year 1984/85, the total value of these transfers was to be in the order of $26 billion.

The three major intergovernmental transfer programs are the Fiscal Equalization Program, the Established Programs Financing (EPF) arrangements and the Canada Assistance Plan (CAP).

The Fiscal Equalization Program provides for annual, unconditional payments to provinces whose capacity to finance public services for their residents is below some determined level. The purpose of equalization is to make it possible for these provinces to provide reasonable levels of public services without having to resort to levels of taxation which are unduly high. In 1984/85, equalization payments were to total some $5.4 billion.

The Established Programs Financing arrangements provide for an equal per capita federal contribution to all provincial governments for the funding of health care and post-secondary education. In 1984/85, EPF transfers were to total $13.4 billion, $7.5 billion of which was to be in the form of cash transfers, and the remaining portion in the form of tax transfers.

The Canada Assistance Plan provides for federal cost-sharing, on a 50-50 basis, of expenditures incurred by provincial governments for social services and income mainte-

nance. In 1984/85, total federal contributions under CAP were to amount to $3.7 billion.

Additional references to these revenue transfer programs appear later in this chapter.

Let's move now from this general overview of financial adaptability and examine some specific areas.

Income security

The flexibility of Canadian federalism is readily apparent in the field of income security. Canadian federalism has created a wide variety of income support programs that could never have been imagined by the founders of our country in 1867. Some of the most important of these are Old Age Security pensions, the Canada and Quebec Pension Plans, Unemployment Insurance and Family Allowances.

Old Age Security pensions
In 1927, Parliament passed the *Old Age Pension Act* under which the Government of Canada would pay half the cost to any province that set up a pension plan for citizens over 70. The maximum pension was $240 a year. Gradually, all provinces joined the plan.

While this was some help to the neediest of Canada's older citizens, by the late 1940s it was apparent that the program did not reflect changes that had taken place in our society. Canadians all across the country wanted a national pension plan that would guarantee senior citizens a greater measure of income security.

The Canadian government established a parliamentary committee to study the matter in depth. It also consulted with all the provinces. At a conference in 1950, there was unanimous provincial approval for a national old age pension scheme. As a result, the *British North America Act* was amended in 1951 to permit the Canadian government to pass the *Old Age Security Act* and implement a program of old age pensions for all Canadians aged 70 or over. Section

94(A) of the *BNA Act* stated that federal law should not affect the operation of any present or future law of a provincial legislature in this area.

Since that time, the pensionable age has been lowered to 65 and other important amendments have been made to the program. A 1966 amendment, for example, provided for the payment of a monthly Guaranteed Income Supplement (GIS) to pensioners who have little or no income other than the OAS pension. In 1975, another amendment introduced the Spouse's Allowance, which may be paid when the spouse of an OAS pensioner is between 60 and 65 years of age and the couple have only a limited income.

Canada Pension Plan and Quebec Pension Plan
In the 1960s, both the national and provincial governments were interested in establishing retirement plans based on individual contributions. Private pension plans existed, but the benefits in those plans were usually lost when people changed jobs. A universal plan was needed to recognize the mobility of Canadians and guarantee them greater income security.

Both the national and provincial governments had the right to legislate in this field because of Section 94(A) of the *British North America Act*, and both the Canadian government and Quebec put forth plans. There were some significant differences. But the stalemate was only temporary. With further consultation, the federal and Quebec governments were able to harmonize their plans. Quebec today has its own pension plan, while in the rest of the country most citizens are covered by the Canada Pension Plan. Both plans are "portable." That means if you move from Quebec to another province, or vice versa, you can take your coverage with you. Contributions and benefits are similar.

Unemployment Insurance
Another example of flexibility in the field of income security is the Unemployment Insurance program. In the 1930s, when the depression put thousands of people in every province out of work, the national government and some provincial governments saw the need for unemployment insurance.

For its part, the Canadian government believed that a national policy was necessary to ensure that all Canadians would receive the same benefit. Unemployment was a prob-

lem all across the country and every unemployed person, wherever he or she lived, had the same basic need. And provinces with the most unemployment needed income redistributed in their favour.

Discussions began in 1937 and continued until 1940, when all the provinces agreed that a federal scheme was desirable. The *British North America Act* was amended to provide for it.

Since the federal Unemployment Insurance legislation includes provisions that make it sensitive to regional needs and changing economic conditions, many adjustments have been made in the program over the years. These changes have provided unemployed Canadians with increased income protection. One contemporary illustration is the change that permits people living in regions of high unemployment to have access to benefits for longer periods of time.

Family Allowances

Yet another example of the give and take that Canadian federalism permits can be seen in the development of Family Allowances. Introduced by the federal government in 1946, the Family Allowance program was a response to the need of families for a certain minimum amount of income maintenance. During the 1920s and 1930s, some of the provinces paid mothers' allowances to the neediest of families, but not every province had been in a financial position to do this.

The national government decided to assist families in every province by providing a monthly payment on behalf of every Canadian child under the age of 16. By the 1960s, some of the provinces were starting to show a renewed interest in this field. Quebec, for example, in 1961 established a provincial youth allowance program to cover 16 and 17-year-olds, providing further income assistance to Quebec families and also encouraging continued school attendance, a condition of the benefit.

None of the other provinces implemented similar measures. But the federal government felt the social and economic circumstances of the 1960s called for a re-examination of Canada's income policies, including the Family Allowance program, and undertook a comprehensive review.

Against this background, federal-provincial discussions began, and culminated in the negotiation of a new federal Family Allowance program in 1973.

Under the program, the Canadian government would provide Family Allowances for all Canadian children under the age of 18. However, any province that needed more freedom in this field to adapt the program to local conditions could request the federal government to vary the rates payable. These could be varied on the basis of the age of the child or the number of children in the family, or both. In addition, provinces that wished to supplement this program with their own allowance scheme could do so.

About 7 million Canadian children in about 3.5 million families all across the country are benefiting from the results of this federal-provincial co-operation. Only Alberta and Quebec have exercised the option of having the family allowance rates varied, but every Canadian family has been guaranteed a larger amount of income support. Quebec also has a provincial allowance program that it finances and administers on its own and Prince Edward Island provides additional provincially-financed benefits for the fifth and subsequent children of families in that province. These benefits are included in the monthly federal cheque. None of the other provinces offers supplementary benefits, but the Family Allowance program's flexibility ensures that a province can make adjustments for local conditions.

Health services

Co-operation between the federal and provincial and territorial governments has given Canadians access to a variety of essential services. Among the most important are hospital and medical insurance. Health care, of course, is clearly a constitutional responsibility of the provinces. Yet the Government of Canada is playing an important role. Canada's comprehensive health insurance package stands as a monument to the flexibility of the system we have developed.

Hospital insurance

In the mid-1950s, there was widespread interest among Canadians in hospital insurance. Saskatchewan, British Columbia, Alberta, Ontario and Newfoundland already had some type of hospital insurance program in effect. But

except for Saskatchewan's plan, they covered only a small percentage of their respective populations. For its part, the federal government was interested in helping the provinces meet the health care needs of Canadians, and offered financial assistance to ensure that residents of every province had access to hospital service.

After initial federal-provincial discussion, the Canadian government proposed a nation-wide system of hospital insurance based on the concept of interlocking provincial plans. Further talks with the provinces produced an agreement that the Canadian government would provide the provinces with approximately 50 per cent of the cost of insured hospital services. It would be a "cost-sharing" arrangement, with each province administering its own hospital insurance program and paying for the other half of the costs. At the same time, the provinces would ensure that the standards of care were uniform across the country and that Canadians moving from one province to another would be protected.

This agreement was embodied in the federal *Hospital Insurance and Diagnostic Act* of 1957. By 1961, every province had adopted a hospital insurance program.

Medical care insurance

Following the successful implementation of the hospital insurance program, many Canadians became interested in insuring themselves against the costs of physicians' services. Both levels of government were also interested in providing this protection. In fact, in the 1950s they had agreed that this should be the second phase in the development of a total health care package. However, not all of the provincial governments felt that it was a priority at that time.

The Canadian government felt it was essential. Private plans existed and three provincial governments had already introduced medical care plans. However, a federal Royal Commission on Health Services (the Hall Commission) found that, while nearly 60 per cent of Canadians had some form of medical insurance, approximately 30 per cent of this insurance was inadequate.

The stage was thus set in 1965 for the federal government to propose the creation of a nation-wide medical program based on interlocking provincial plans. Upon provincial agreement, the federal government was prepared to contrib-

ute, nationally, 50 per cent of the insured costs to provinces that enacted medicare plans. Again, the provinces would be required to comply with certain conditions to ensure national standards and protection for Canadians moving from one province to another. They would administer this cost-sharing program just as they did the hospital insurance program.

It took time and negotiation to gain the agreement of enough provinces, but in 1968 Parliament passed the *Medical Care Act*. The provinces in turn passed legislation to set up their own medical insurance programs.

Provincial administration of these programs has enabled the provinces to develop different ways of delivering these services and of financing their share of the costs, according to local needs and conditions. Consequently, there is considerable diversity from province to province. Some provinces administer their plans through separate funds or commissions; others operate them as part of their health departments. Some provinces use a system of premiums or payroll taxes to finance a greater or lesser part of their share of the costs; other provinces finance their share exclusively from general tax revenues.

Since the inauguration of the health care programs, continuing federal-provincial co-operation has given the provinces increased flexibility in both the financing and the adaptation of these services to local needs.

However, the provinces claimed that requiring them to share the costs on a 50-50 basis led them to accept spending priorities and a choice of service not necessarily best suited to their needs or their financial means.

In 1977, the previous agreements were replaced by an arrangement known as Established Programs Financing (EPF). It provides for a federal contribution based on a combination of income tax transfers and cash payments to the provinces. The total federal contribution to each province is equal, per capita, and it grows from year to year with the rate of growth of the economy.

As a result, the principle of federal contributions to provincial programs remains intact. And the provinces have greater flexibility to set their own spending priorities.

Thus Canadians have a health insurance system that is national in scope, and both levels of government help to finance it without stepping on one another's constitutional toes.

Perhaps nothing attests to this ability of the federal provincial partnership to adapt and innovate more than the compliment paid to Canada during the visit of the then American Secretary of Health, Education and Welfare, Joseph A. Califano Jr., in 1977. Acknowledging that Canada was 20 years ahead of the United States in the provision of health care services, he said that Americans would use our program as a guide for the development of their own national system. He said Canada's system is "one of the most valuable guides we can have—a marvellous fund of knowledge about one of the most important social and political issues of our era."

Canada's success in implementing cost-sharing arrangements with the provinces has not been limited to health care. Over the years other cost-sharing arrangements have also been implemented to provide important services to Canadians. Through the Established Programs Financing, the federal government also contributes to the cost of post-secondary education. Under EPF, federal government payments to the provinces in 1984/85 were to exceed $14 billion.

Economic policy

Regional development

The flexible nature of Canadian federalism can also be seen in the field of economic policy. Since 1867, one of the national government's most important functions has been to implement economic policies that harmonize the regional economies in Canada and promote balanced regional development. In the late 1950s, the federal government decided that some of the funds generated by the rapid economic growth in certain regions should be allocated to the more slowly developing areas through specific programs that would promote development. Since the provinces were also starting to show an interest in this field, the Canadian government felt that it would be useful for the two levels of government to co-operate and work out suitable programs.

Consultations were undertaken with the provinces, culminating in the *Agricultural and Rural Development Act (ARDA)** in 1961, the forerunner of later federal-provincial schemes for economic development. Under this act, the Canadian government and the provinces entered into agreements that provided for joint financing of land and water conservation programs to alleviate poor economic conditions in rural areas. In addition, the Fund for Rural Economic Development (FRED) was introduced in 1966 to provide assistance to those areas requiring resources beyond those supplied by ARDA. Again, agreements were entered into with the provinces, but in this case, the emphasis was shifted to industrial rather than agricultural development.

Alongside these joint programs, individual provinces also instituted regional development policies so that, by 1969, both orders of government had moved a considerable distance in dealing with the problem of regional disparities.

One major federal initiative was the creation of the federal Department of Regional Economic Expansion (DREE) in 1969. This enabled all the joint federal-provincial programs to be co-ordinated for the first time, and, with a reorganization in 1973, the department was able to provide continuing on-site analyses of economic and social circumstances in all slow-growth areas of Canada. This reorganization involved massive decentralization of staff, administration and decision-making authority. DREE offices, headed by directors general, were established in the 10 provincial capitals. Regional offices, directed by assistant deputy ministers, were set up in Moncton, Montreal, Toronto and Saskatoon to co-ordinate activities in their particular regions.

The bulk of DREE's initiatives involved longer term projects cost-shared with provincial governments. In these projects, DREE was able to assist the provinces in identifying and realizing their opportunities for development, without infringing on their priorities.

In January of 1982, the federal government announced plans to streamline its approach to economic development, involving the reorganization of a number of departments and agencies.

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* ARDA programs have now expired in all provinces, with the exception of a Special ARDA program for native people in Manitoba, Saskatchewan and British Columbia.

The purpose of this reorganization is to increase the capacity of the government to help Canadians in all regions to take better advantage of major economic and employment opportunities, and to provide a government-wide focus on regional economic development and the promotion of export trade.

As a result, DREE no longer exists. A new Department of Regional Industrial Expansion (DRIE) came into being in 1983. It took over some of DREE's programs, and incorporated parts of the former Department of Industry, Trade and Commerce.

Equalization
Canada also provides assistance through equalization payments to provinces with the least revenue-producing capability so they can provide a basic standard of essential public services without imposing unduly high taxes.

This notion of sharing dates back to the time of Confederation. In 1867 the Constitution provided for the payment of subsidies to Nova Scotia and New Brunswick. Over the years that followed there were various special grants to the provinces to help them out in times of need.

But the system of annual payments based on revenue-raising capacity did not begin until 1957, when there was increasing pressure on the provinces to expand services in the fields of education, health and social security.

Unlike the equalization programs in some federal systems, the Canadian program is totally unconditional. The provinces are free to use the money given them for any purpose whatsoever. Thus equalization stands as an example of both the flexibility and the decentralized nature of the Canadian federation.

The amount of equalization payments is based on a formula that is sensitive to changing economic circumstances of provinces, and hence to their ability to raise revenues in any particular year. In fact, over the years, the formula has been refined after extensive consultations with the provinces so that today it is based on almost the entire range of provincial

taxes including income taxes, general sales taxes, special consumption taxes levied on alcohol, tobacco, gasoline, etc., property taxes levied by local governments, and various kinds of royalties and levies on natural resources.

As of 1984 British Columbia, Alberta, Saskatchewan and Ontario were not receiving equalization payments because their per capita capacity to raise revenue is above the standard specified by the formula. But of the 10 provinces, Ontario is the only one that has *never* received payments. Alberta, for example, was assisted considerably through equalization in the 1950s and 1960s, just as other provinces are being helped now.

With proclamation of the *Constitution Act, 1982*, the long-established principle of sharing the national economic strength became more than a tradition. By unanimous agreement, equalization was entrenched in the Canadian Constitution, along with a commitment by all governments to promote equal opportunities for all Canadians, further economic development to reduce disparity in opportunities, and provide essential public services of reasonable quality to everyone.

Drawing upon the strength of some regions to relieve the temporary difficulties of others is the very essence of equalization. It is also central to the Canadian concept of federalism.

Immigration

The Canadian government and the provinces were given concurrent powers in immigration matters under the Constitution by Section 95 of the *British North America Act*. However, federal legislation has precedence over provincial legislation when differences exist because immigration has important national dimensions. For instance, it is strongly related to national security. Also, it has a profound effect on our labour supply and growth of economic activity.

Since 1867, the Canadian government has implemented immigration laws based on Canada's changing needs. However, in the last few decades the provinces have also

become more involved in this field. Quebec showed its interest in immigration, for example, by establishing a department of immigration and by taking measures to encourage francophone immigrants to live in the province.

The federal government welcomed Quebec's initiatives in this field and took steps to help immigrants already established in the province to learn the French language and to adjust to life in their new home. The federal government also took steps on its own to help Quebec attract immigrants who were suited to its manpower and cultural needs. Several immigration offices were opened in different francophone countries. A large publicity campaign was also undertaken in countries such as France and Belgium to encourage francophone immigration. A third step was worked out with Quebec so that both levels of government could work closely together and pool their resources to achieve maximum success in attracting new immigrants.

Discussions were also held on the subject of Quebec's role in selecting immigrants, and in February 1978 an agreement was reached to give the province a greater say on who could move there from other countries.

To cite other examples of federal-provincial co-operation, in 1978 the Canadian government also concluded separate immigration agreements with Nova Scotia and Saskatchewan, based on their special needs and priorities. The agreement with Nova Scotia provides for a federal-provincial immigration committee, to consult on such matters as levels of immigration, policies involving people seeking to immigrate to Nova Scotia or to work or study in the province, and the priorities for processing immigrant applications. The agreement with Saskatchewan also provides for a joint immigration committee to ensure continuing co-operation in matters of demography and the employment of immigrants and foreign temporary workers. In addition, the agreement outlines the responsibilities of both orders of government for settlement services for immigrants.

An international perspective

A look at how revenues are distributed among levels of government in a number of countries can give us an idea of the extent of decentralization in Canada compared with other federations.

As the following table shows, the national government's share of total government revenues in Canada is smaller than that of the central governments in most other federations.

Table 4

Revenues from own sources as a share of total current government receipts, by order of government, 1976 and 1981

	1976	%	1981	%
Australia[1]				
Total current receipts	26,460		50,827	
Central government current receipts	20,439	77.24	39,622	77.95
State/local government current receipts	6,021	22.76	11,205	22.05
United States[2]				
Total current receipts	407,191		729,372	
Central government current receipts	228,677	56.16	441,785	60.58
State/local government current receipts	178,514	43.84	287,587	39.42
Canada[3]				
Total current receipts	62,215		116,775	
Central government current receipts	31,204	50.16	56,664	48.52
State/local government current receipts	31,011	49.84	60,111	51.48
West Germany[4]				
Total current receipts	314,950		434,980	
Central government current receipts	159,430	50.62	222,230	51.09
State/local government current receipts	155,520	49.38	212,750	48.91
Switzerland[5]				
Total current receipts	34,655		42,495	
Central government current receipts	13,700	39.53	17,120	40.29
State/local government current receipts	20,955	60.47	25,375	59.71

SOURCE: *National Accounts*, 1964-1981, Volume II, OECD.

[1]millions of Australian dollars; fiscal years beginning July 1

[2]millions of U.S. dollars

[3]millions of Canadian dollars

[4]millions of Deutschmarks

[5]millions of Swiss francs

However, it is necessary to consider more than just the distribution of revenues when analyzing the degree of decentralization in the various federations.

Figures provided by Statistics Canada reveal that, in 1983, total government spending (excluding hospitals) on goods and services and capital formation at all levels in Canada was around $82.4 billion. Of this, the federal government spent $21.6 billion or 26.2 per cent of the total, while the provinces spent $30.1 billion and the municipalities $30.7 billion, for a combined provincial-municipal expenditure amounting to 73.8 per cent of the total.

It should be noted that the provincial-municipal spending figures include the expenditure of funds received through transfer payments from the federal government, under various cost-sharing programs and equalization.

It must also be emphasized that the Canadian provinces have a wider field of jurisdiction than that enjoyed by the member states or provinces in West Germany, the United States and Switzerland.

The Canadian provinces have greater financial autonomy in terms of fiscal resources and borrowing power, for example, than the states or provinces in any other federation, with the possible exception of Switzerland.

Canada's provinces also have more political power than do the states or provinces in any other federal system, including that of Switzerland. In fact, the Canadian provinces play an important and necessary part in the development of national policy through federal-provincial conferences, where most of the major issues of the day are discussed.

Canada's Established Programs Financing (EPF) approach and the equalization payment formula are unique in the world. There is no corresponding program in the United States and, while some other federations do have very important systems of equalization, the Canadian program appears to be the largest of its kind and also the most advanced in measuring differences among provincial governments with respect to their capacity to raise revenues.

Certainly it is evident that, overall, Canadian federalism represents one of the most decentralized approaches to

government in the world. In some of the aspects covered here, there is no question that our level of decentralization is unsurpassed in any other federation. This fact is particularly significant considering the general tendency toward centralization occurring in many other federations.

Conclusion

There are other examples that could be cited to demonstrate the flexible and adaptable nature of the Canadian federal system. However, based on this brief examination, the following observations are offered:

- The Canadian federal structure can meet the economic and social needs of Canadians. It is doing so through such measures as Old Age Security, Unemployment Insurance, incentives to regional development, equalization payments and federal-provincial co-operation in immigration matters.
- The federal system promotes co-operation between the two levels of government and permits them to develop creative arrangements to meet the needs of all Canadians. Consider the fact that some of these needs were met by constitutional amendments, while others were met by formal agreements. In the case of retirement plans, the need of retired Canadians for income security was met by agreeing on one province having a greater measure of autonomy than the others. The ability of Canadian federalism to accommodate such a variety of arrangements has been an important factor in promoting responsive government and accommodating the special needs of the provinces, whether they be cultural, economic or social.
- The process of negotiation and discussion in the Canadian federal structure has ensured that provincial interests are brought to the fore. In a sense, citizens are represented twice in national policy-making, by the Canadian government and by their respective provincial governments. At the same time, the decentralized nature of the process ensures the vitality and autonomy of the provinces so they can effectively discharge their strictly provincial responsibilities.
- Intergovernmental co-operation promotes stability and continuity, two essential elements of responsive and responsible government. The federal government and the provinces have been able to work together to amend the

Constitution when circumstances indicated that it was necessary. This has permitted great changes to take place in Canada without any abrupt breaks with the past. For example, the founders of our country did not foresee the need for services such as old age pensions or unemployment insurance, but intergovernmental co-operation has permitted orderly constitutional change so that all Canadians can have access to these two essential programs.

- The flexible nature of Canadian federalism permits fluctuations in the power relations between the two orders of government as our needs change and other circumstances dictate.

  As recent examples of flexibility have shown, since the 1950s the trend has been toward decentralization with the power shifting, and continuing to shift, to the provinces. As a result, today Canada is—by virtually any measure—one of the most, if not the most, decentralized federations in the world. By contrast, in the 1940s, the trend was toward centralization as power shifted to Ottawa to enable it to deal with the demands of World War II and the post-war reconstruction period.

  The founders of our country thought in terms of creating a highly centralized governmental system in Canada, but the flexible nature of federalism has permitted constant change so that neither order of government has been locked into a rigid position.

- Finally, there are limits to the flexibility of Canadian federalism.

  If Canada becomes too decentralized, it will cease to be a federation. Instead, Canada will become a loose association of political units in which the effectiveness of the national government is dependent upon the will of the provinces.

  This fragmentation would be incompatible with Canada's goals. It would jeopardize the ability of the national government to manage the economy, to deal with economic fluctuations and to contribute to rising living standards for the people of Canada. It would weaken the willingness of individual Canadians to contribute toward the well-being and progress of their fellow citizens in the other prov-

inces. And, it would weaken Canada at a time when size as well as excellence count in the struggle for economic, technological and cultural achievement.

Of course, excessive centralization or a trend toward a unitary state would be equally inconsistent with Canada's character—with its cultural diversity, with its vast size and distances that call for the extensive decentralization of government, and with the freedom that is characteristic of states where government powers are widely dispersed.

Indeed, with either excessive centralization or excessive decentralization, Canada would cease to be a federation.

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